**Management Advisory Report:  The Small
Business/Self-Employed Division's Collection
Process Improvement Effort Will Not
Adversely Affect Internal Controls,
but Potential Risks Still Exist**

**May 2002**

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May 17, 2002

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

FROM:　　　　　　　Pamela J. Gardiner
　　　　　　　　　　Deputy Inspector General for Audit

SUBJECT:　　　　　Final Management Advisory Report - The Small Business/Self-
　　　　　　　　　　Employed Division's Collection Process Improvement Effort
　　　　　　　　　　Will Not Adversely Affect Internal Controls, but Potential
　　　　　　　　　　Risks Still Exist  (Review #200230004)

This report represents the results of our review of the preliminary recommendations of the Small Business/Self-Employed (SB/SE) Division's Collection Process Improvement Team.  The overall objective of this review was to provide ongoing input regarding the SB/SE Division's collection process improvement effort.  Specifically, we assessed the impact of the team's recommendations on the internal control environment and on taxpayer relations/rights.  This management advisory report is provided for informational purposes to assist Internal Revenue Service (IRS) management in its efforts to modernize the IRS.

In summary, the preliminary recommendations proposed by the SB/SE Division's Collection Process Improvement Team should not adversely affect the existing control environment.  The Team has been proactive in identifying risks and working to reduce them, has involved other appropriate IRS functions on an ongoing basis, and has considered communication and training needs to be addressed for successful implementation of the recommendations.

However, we believe some risks still need to be considered as the recommendations are being implemented.  These risks include the feasibility of getting managers more involved in case guidance, the difficulty in measuring the impact that changes will have on collection effectiveness, and potential security risks when using Microsoft Outlook Calendar to schedule meetings.  Also, some of the sub-teams are still actively identifying issues to consider, so risks should continue to be identified and resolved as improvement efforts continue.  Finally, the executive in charge of the Collection

Reengineering projects recently received a new job assignment. We believe that the Commissioner, SB/SE Division, should appoint a new executive leader to facilitate project direction and implementation of the recommendations.

Since we are making no recommendations in this management advisory report, a response is not required. Copies of this report are also being sent to the IRS managers affected by the report. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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## Background

The Small Business/Self-Employed (SB/SE) Division's Collection function is responsible for promptly collecting the proper amount of federal tax due from taxpayers.  This includes securing tax returns that are not filed in order to determine the tax due.  Over the last several years, collection business results, such as the number of accounts closed, have declined, and the number of accounts not being worked has increased.  In an effort to improve operations, the Commissioner, SB/SE Division, established teams staffed with employees of the Internal Revenue Service (IRS) and an outside consulting agency to review Collection function operations and suggest methods for improvement.  These teams are commonly referred to as Collection Reengineering teams.

One of the Collection Reengineering teams is the Collection Process Improvement Team.  Its project work plan includes an assumption that the Team would recommend process improvements in key areas, but would not produce an overall reengineering of all processes and procedures.  Another assumption was that the Team would not analyze or recommend system or technology improvements that would involve a major commitment of computer programming resources.  These assumptions allowed the Team to concentrate on incremental process improvements that could be accomplished in a relatively short time frame without redesigning the overall process.  As a result, this project is truly what its name suggests – a "process improvement" effort – rather than a full-scale "reengineering" of Collection function processes.  In a 1997 guide,[1] the General Accounting Office distinguishes "reengineering" efforts that focus on redesigning a process as a whole, from "process improvement" efforts that focus on functional or incremental improvement.

The objective of the Collection Process Improvement Team was to stabilize and improve the SB/SE Division Collection function's operational performance by identifying and implementing high-impact, near-term improvements to case assignment, processing and resolution processes.  The

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[1] *Business Process Reengineering Assessment Guide* (May 1997).

project's scope included the three Collection functions: the Service Center Campus Collection Branch,[2] the Automated Collection System (ACS),[3] and the Collection Field function (CFf).

We conducted this review in the Oxon Hill and New Carrollton, Maryland, IRS offices from July 2001 to April 2002. It was conducted in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*. Information on our objective, scope, and methodology is presented in Appendix I. Major contributors to this report are listed in Appendix II.

Another Collection Reengineering project, the Collection Quick Hits,[4] was tasked with identifying some ideas that could be implemented in a very short time frame. One idea that came out of that project was a new method to prioritize inventory for assignment in the field. Since we were not involved in that project, the observations in this report are limited to the Collection Process Improvement project. We will be assessing the effectiveness of the inventory prioritization method in a separate review.

## Initial Recommendations Should Not Adversely Affect Internal Controls

The preliminary recommendations made by the Team should not negatively affect the existing internal control environment. In fact, some of the proposed recommendations could improve the control environment. For example, the CFf team is recommending a structured approach to drive discussions between group managers and revenue officers (RO)[5] on each case assigned to an RO. The team believes this will facilitate timely case decisions and resolution. Other recommendations are designed to facilitate workload selection or improve existing processes.

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[2] The Service Center Campus Collection Branch handles bulk processing, such as mailing balance due and tax return delinquency notices and responding to taxpayer correspondence.
[3] The ACS is a telephone collection system where telephone assistors collect unpaid taxes and secure delinquent tax returns.
[4] Collection Quick Hits recommendations were completed on June 28, 2001, and are in various stages of implementation.
[5] An RO is a CFf employee that attempts to contact taxpayers to collect balance due amounts and secure delinquent tax returns.

**Many Risks Are Being Addressed, but Some Still Exist in Implementing the Current Recommendations**

The teams have been proactive in identifying risks and working to reduce them.  They engaged the employees union, SB/SE Division Counsel, functional operations, and the Taxpayer Advocate's Office on an ongoing basis as the recommendations evolved.  Timely addressing potential barriers in this manner should facilitate implementation of the recommendations.  The teams have also been considering communication and training needs to be addressed for successful implementation of the recommendations.

However, we believe some risks still need to be considered as the recommendations are being implemented.

**Management involvement**

A design concept for the CFf provides for management involvement (i.e., consultations between group managers and ROs) on a routine basis.  Historically, however, managers have spent a significant amount of time on administrative issues and had limited time to spend reviewing cases.  In fact, almost 20 years ago, IRS Inspection (now the Treasury Inspector General for Tax Administration (TIGTA)) recommended that group managers be more actively involved in case activity at an early stage.[6]  The Collection function responded to the report by stating that span of control, review schedules, and administrative duties hindered the ability of group managers to become involved in active cases at an early time, but they agreed with the recommendation's concept and responded that they would look at the group manager occupation in order to achieve the goal.  However, the group managers are still burdened with non-case related activities that occupy much of their time.

The SB/SE Division established the Burden Reduction Task Force, which presented its recommendations at the SB/SE Division's Leadership Conference held October 30 to November 1, 2001.  Part of the team charter was to reduce non-core (e.g., administrative) duties to allow managers to

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[6] *Efficiency of the Collection Field Function* (Reference Number 05197, dated July 24, 1985).

spend at least 75 percent of their time on core responsibilities.  As the recommendations were being discussed at the conference, managers expressed concern that many administrative duties still continue to occupy their time.

Overcoming these beliefs and Collection function management practices engrained over time will be significant challenges to the successful implementation of the Collection Process Improvement Team's recommendations.  The Team is well aware of these challenges and is planning to address them by:

- Requesting support for the concept from top-level SB/SE Division management.

- Replacing existing group manager review requirements with the consultations.

- Developing measures and oversight requirements to help ensure that the design is implemented at the group level.

- Developing communication and training plans that are designed to address resistance to the process expressed by managers.

Even with these planned efforts, we believe it will take a great deal of continuing commitment and oversight from upper-level SB/SE Division management to effectively implement the design at the group level.

**Measuring success**

The CFf team is planning to incorporate measures and oversight requirements in the design of the consultation process, mentioned above, to identify whether group managers are effectively using the process.  While this is important, also important is measuring the impact of process changes on collection effectiveness and timeliness.  We believe it will be difficult to measure the impact of this process since other initiatives are being implemented almost simultaneously that should also impact the effectiveness and timeliness measures.

One of these initiatives is the revised inventory
prioritization recommended by the Collection Quick Hits
Improvement Team.  One of the elements of the revised
priority system is that taxpayers will be contacted sooner
after non-compliance is identified.  It is believed that this
will decrease the time required to resolve the non-
compliance and reduce accounts receivable.  Another team
is recommending a way to predict the outcome of a case
earlier in the collection process.  This should enable the
Collection function to apply its resources to more
productive cases.  In addition, more employees should be
able to work cases since the SB/SE Division hired
additional ROs in Fiscal Year 2001 and is re-deploying
fewer employees to provide direct assistance to taxpayers
during the Filing Season.[7]

Management will have difficulty determining whether any
productivity gains are attributable uniquely and directly to
these recommendations, to the increase in resources spent
on collection activities, or to other factors.  It is also
possible that the overall results will show an improvement
in the measures, but one or more of the recommendations
could actually have a negative impact.  Decision-making
ability is hampered when the success of individual
initiatives cannot be measured.  The executive in charge of
the effort also realized this could be a concern and
submitted a proposal for a study to determine the impact
and results of the project's recommendations.  As of
April 2002, SB/SE Division management had made no
decision on whether to fund the study.

**Calendar use**

The CFf team is recommending that group managers use
Microsoft's Outlook Calendar for scheduling consultations
with ROs on specific cases.  The Team recognized there
could be risks involved with using the Calendar and
requested an opinion on the issue from the IRS' Information

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[7] The Filing Season is the period from January through mid-April when
most individual income tax returns are filed.  During this period, the
Collection function has historically assigned hundreds of employees to
assist taxpayers with their questions.

Technology and Disclosure functions.  Management informed us that the Disclosure function responded that the Team could proceed with the design as is.  The Team is still working with the Information Technology function on the issue.  We believe that security features built into the Calendar present some disclosure risk and that the Team should continue to pursue an opinion from Information Technology.

In July 2001, Microsoft issued an alert about the potential for unwanted users gaining control over Outlook E-mail and Calendars.  In August 2001, Microsoft provided a programming change to fix the vulnerability addressed in the alert.  However, there may be other concerns that have not been addressed.  A web site we researched posts concerns about many computer programs.  It has posted some concerns regarding Microsoft Outlook and reports that Microsoft has not addressed all of them.  We did not attempt to validate the information on the web site.

In addition, Calendar data flowing between IRS offices may not be entirely secure.  The IRS uses encryption[8] to safeguard data flowing between its offices over communication lines.  However, in an October 2001 Limited Official Use Report, the TIGTA cited some concerns over the IRS' encryption process.[9]  Calendar data would flow over communication lines to display the information on remote terminals when territory managers, group managers, and ROs are not co-located in an IRS office.  Additional concerns exist if the Calendars can be accessed from outside of the IRS offices where the data might not be subject to existing IRS encryption processes.

While the Team's design concept of only entering a few letters of the taxpayer's name in the Calendar should help limit disclosure risks, there is no systemic control preventing the entire taxpayer name and other sensitive

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[8] Encryption is a scrambling process to prevent unauthorized reading of data without the proper coding to unscramble the data.
[9] *The Internal Revenue Service Encrypts Data Transmitted Between Its Facilities, But Controls Over Cryptography Can Be Improved* (Report Number 2002-20-007, dated October 2001).

information from being entered in the Calendar. This, combined with the issues noted above, increases the risks that taxpayers' identities might be disclosed to those who do not have a need to know.

After we discussed these concerns with the team leaders, they advised they would add additional features to the design to further limit disclosure risks. Group managers will be required to use a code for taxpayers with short or unique names that could be easily identified even if only a portion of the name was entered. In addition, they will make territory managers responsible for reviewing the Calendar to ensure that taxpayers cannot be identified through the portion of the taxpayer name that is input. These efforts should provide interim controls to reduce disclosure risks. A long-term solution should be to incorporate the Calendar function into modernization efforts to further reduce disclosure concerns and integrate the function with the existing Collection function case database. This would also make the Calendar more efficient by eliminating the need to enter a taxpayer identifier and action item in a separate system.

**Risks Still Need to be Addressed as Improvement Efforts Continue**

The executive in charge of the Collection Reengineering projects recently received a new job assignment. We believe that the Commissioner, SB/SE Division, should appoint a new executive leader to facilitate project direction and implementation of recommendations, especially since some of the initial recommendations are close to the implementation stage and other teams are still actively identifying issues to address.

The following teams are still active and are identifying issues to address. Risks should continue to be identified and resolved as recommendations from these teams evolve.

- The Installment Agreement[10] Team is just starting a risk analysis phase. During this phase, it will try to identify risks that indicate that taxpayers might not remain current with their installment payments, and

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[10] An installment agreement is a payment agreement that allows the taxpayer to pay a balance due over a period of time.

to develop alternate processing actions and treatment options for these taxpayer installment agreements.

- The ACS Team is analyzing the productivity of its case work.  An offshoot of the ACS Team is just starting to look at the mission of the ACS and how best to accomplish the mission.

These teams are currently identifying some preliminary areas to make recommendations for improvement.  The following are examples of areas that need to be closely monitored by SB/SE Division management as recommendations evolve:

First, the Installment Agreement Team is considering the use of incentives to help ensure that taxpayers remain current with their installment payments.  We believe this needs careful consideration to avoid inequitable taxpayer treatment and legal issues.  For example, an earlier idea for incentives was the use of varying interest rates for balance due amounts.  This type of incentive would require a legislative change since the Internal Revenue Code (IRC) dictates the interest rate.  While applying varying interest rates based on risk factors is a commonly accepted practice in the private sector, it could be considered inequitable taxpayer treatment in the public sector and might not be well received by the Congress if a change to the IRC is requested.

Second, the ACS Team is reviewing the impact of making outgoing telephone calls versus sending tax balance due notices to taxpayers.  Traditionally, the IRS has used notices to try to collect accounts due, but they frequently result in telephone calls from taxpayers to the ACS with questions about information in the notice.  Historically, answering these calls limited the IRS' ability to make telephone calls to taxpayers in an attempt to collect tax due.  To make additional outgoing calls, the IRS would either need to increase staffing or reduce the volume of notices issued.  Reducing the volume of notices issued should result in fewer incoming telephone calls, thereby freeing up resources to make outgoing calls.  However, the potential impact needs to be thoroughly studied before any change is

made, especially given the IRS' limited ability to make outgoing calls in the past.

## Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide ongoing input regarding the Small
Business/Self-Employed Division's collection process improvement effort.  Specifically, we
assessed the impact of the team's recommendations on the internal control environment and on
taxpayer relations/rights.  In order to accomplish our objective, we:

I.      Reviewed decks (documents) the Team prepared that described its activities and
        recommendations.

II.     Participated in weekly leadership meetings.

III.    Attended bi-weekly content meetings.

IV.     Attended steering committee meetings.

V.      Researched Internal Revenue Service Inspection Division and Treasury Inspector General
        for Tax Administration audit reports related to areas being pursued by the Team and
        provided copies of the reports to the appropriate team.

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**Appendix II**

# Major Contributors to This Report

Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs)
Parker F. Pearson, Director
Amy Coleman, Audit Manager
Anthony Choma, Senior Auditor
Joseph Snyder, Senior Auditor

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